

**United States Senate**  
**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**  
*Committee on Governmental Affairs*

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**Senator Norm Coleman, Chairman**  
**Senator Carl Levin, Ranking Minority Member**

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**OPENING STATEMENT**  
**SENATOR NORM COLEMAN**

Thank you for attending today's hearing. Today and Thursday we will focus on a set of issues developed by this committee's Ranking member, Senator Levin. I would like to commend Senator Levin for his tireless efforts to prevent the abuse of our tax code by those willing to exploit loopholes and avoid legitimate taxes.

In a bi-partisan fashion, PSI has developed a deeper understanding of the history of individual tax shelters. PSI has uncovered how these shelters work, how they were marketed to potential investors, and how they were structured in order to avoid scrutiny by the Internal Revenue Service. Due to the complexity of these schemes, our hearings will focus on only a few of the shelters, but there were many others like them.

There is an old English proverb that says, "A clean glove often hides a dirty hand."

Today, we will hear, firsthand, how the ethical standards of the legal and the accounting profession have been pushed, prodded, bent and, in some cases, broken, for enormous monetary gain.

The fact is, abusive and potentially illegal tax shelters sold to corporations and wealthy individuals rob the U.S. Treasury of billions of dollars in lost tax revenues annually.

Let me be clear. While some of the products we discuss today are not technically illegal – they are most certainly ethically questionable and demonstrate a deliberate effort on the part of the participants to fly underneath the regulatory radar of the IRS.

This is not a victimless crime. It is not the government that loses the money. It is the people of America – average working families – who will bear the brunt of lost revenue so that a handful of rich lawyers, accountants and their clients can manipulate legitimate business practices to make a profit.

According to GAO, a recent IRS consultant estimated that for the six year period, 1993-1999, the IRS lost on average between \$11 and \$15 billion each year from abusive tax shelters. GAO reports that an IRS database tracking unresolved, abusive tax shelter cases over a number of years estimates potential tax losses of about \$33 billion from listed transactions and another \$52 billion from nonlisted abusive transactions, for a total of \$85 billion.

As I said, this is not a victimless crime.

To put this in context, if the IRS proactively shut down these abusive tax shelters and collected the diverted revenue, it would have helped to finance a substantial portion of our efforts in Iraq.

Abusive tax shelters are fashioned in the likeness of legitimate transactions as permitted under the IRS Code. The transactions themselves are highly complex involving accounting firms, major financial institutions, investment firms, and prestigious law firms.

Not only are these participants necessary for the transactions, they provide the added benefit of making detection by the IRS difficult. Moreover, these entities provide a “vener of legitimacy” for abusive tax shelters that are, in fact, illusory or “sham” transactions with little or no economic substance driven primarily for favorable tax consequences.

There are three overarching issues that these hearings will address.

The first is the Internal Revenue Service’s ability to enforce the nation’s tax laws. There is no doubt that our tax laws are very complex and can give rise to different interpretations. The Service’s interpretation is not legally controlling and taxpayers have a right to ignore it if they think a court will uphold their reading of the statutes and regulations. But the IRS does have a right to challenge tax strategies it thinks are invalid. In order for the Service to challenge strategies and for the courts to rule, they must be aware of how taxpayers are applying the law.

The Subcommittee’s investigation has uncovered evidence that the transactions studied here were deliberately designed to avoid detection by the IRS. Even an illegal strategy works if the government never finds out about it. Even more disturbing, the IRS has specific rules that require the promoters of certain tax products to notify the IRS whenever a taxpayer uses one of them. This gives the IRS the opportunity to review how the taxpayer has applied tax law to his specific situation.

Evidence suggests that the accounting firms knowingly evaded this requirement – and that the IRS has not been as forceful in its administration of this registration requirement as it could be.

When transactions are hidden from the government, it loses its ability to enforce the tax law. The perception can quickly arise that fair application of revenue statutes is a sucker’s game. That all the rich and powerful ignore it or interpret it to their own benefit and that only the average guy gets stuck with his full share. A system that relies primarily on voluntary compliance cannot afford to allow this perception to seem real.

Second, for a long time both the accounting and legal industries have been justifiably proud of their professional traditions. Both have held themselves up to the public as practicing a high standard of professional ethics and giving the public honest access to a complex body of doctrine. Given the complexity of tax accounting and law, Americans with any wealth are increasingly dependent on professional advice in order to make reconcile their personal interests with legal requirements. If clients cannot have absolute confidence in the accuracy of the advice they get, then these professions no longer merit the high standard we have previously given them.

This leads naturally to the third major theme of these hearings.

We all know that an institution, especially on as large as the accounting firms appearing here today, cannot be held strictly responsible for every action of all its employees. Individual workers often have motives and take actions that are directly contrary to the intentions of a company’s leaders. But because we foresee these conflicts, the existence of strong internal controls has become a key component of modern management

practices. These controls are meant to ensure that no single employer or group of employees is allowed to subject the firm to a large amount of risk without the leadership's approval.

We will hear evidence that the internal controls that the accounting and law firms seem to have had in place did not work. The people who were responsible for ensuring firm quality often raised serious questions about the transactions we will discuss today. Yet their advice and recommendations were often disregarded in the effort to boost revenue.

These three issues: The ability of the IRS to learn of aggressive tax strategies, the possibility of misleading advice to taxpayers, and the breakdown in internal controls all raise serious issues about future policy toward the tax industry. I am hopeful that the information Senator Levin has helped us uncover will lead to positive reforms.

I look forward to hearing from our panelists this morning and I especially look forward to Senator Levin's questioning of the panelists. I know we will all learn a great deal today.

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